DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 98-0500
Sales and Use Tax
For the Tax Years 1995, 1996, and 1997

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ISSUE

I. Applicability of the State Gross Retail Tax on Items of Equipment Leased to Taxpayer.

Authority: IC 6-2.5-2-1; IC 6-2.5-5-3(b); 45 IAC 2.2-4-27; 45 IAC 2.2-5-8; 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(g).

Taxpayer argues its lease of certain items of equipment – consisting of metal fabricating machinery – is exempt from imposition of the sales tax because the leased equipment is entitled to the manufacturing exemption.

STATEMENT OF FACTS

Taxpayer is a self-styled "farm supply" dealer. Taxpayer also fabricates certain items related and unrelated to farm equipment. Taxpayer produces, sells, and installs grain handling, storage, and conditioning equipment. Taxpayer also fabricates sprayer equipment, parts for recreational vehicles, parts for horse trailers, parts for grain handling equipment, metal farm gates, and certain other specialized metal parts. Taxpayer protests the assessment of sales tax on the lease of 20 items of metal fabricating equipment used in constructing these various metal parts.

This equipment was initially purchased by taxpayer's "sister" corporation and then "leased" to taxpayer. The audit determined that because the lease of tangible personal property was a retail transaction, taxpayer, as the lessee, was responsible for paying sales tax on the "leased" equipment. During the initial review of the taxpayer's protest, the appeals analyst found that the "leasing" of the equipment was a taxable transaction because taxpayer and sister corporation (lessor) were separate tax entities. Other than the issue of whether the lease payments are subject to the imposition of the sales tax, taxpayer does not challenge the audit's factual determinations concerning the nature of the transactions with the lessor. Rather, taxpayer maintains that the 20 items of equipment fall within the manufacturing exemption and that, as a result, taxpayer's lease of the equipment should not be subject to sales tax.

DISCUSSION

I. Applicability of the State Gross Retail Tax on Items of Equipment Purchased and Then Leased to Taxpayer.

Pursuant to IC 6-2.5-2-1, a sales tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. In addition, 45 IAC 2.2-4-27 imposes the sales tax on gross receipts derived from the renting or leasing of tangible personal property. That same regulation exempts those lease payments which would be exempt in an equivalent sales transaction.

Under IC 6-2.5-5-3(b), 45 IAC 2.2-5-8, an exemption from the state gross retail tax is provided for transactions involving manufacturing machinery, tools, and equipment if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. 45 IAC 2.2-5-8(c) defines "direct use" as that use having an immediate effect on the article being produced. Property has such an immediate effect if it is an essential and integral part of an integrated process that produces tangible personal property. 45 IAC 2.2-5-8(g). Therefore, in order to qualify for the manufacturing exemption, taxpayer must establish that the functions performed by the leased metal fabricating equipment constitute an essential and integral manufacturing process that produces tangible personal property as defined within IC 6-2.5-5-3(b) and 45 IAC 2.2-5-8(g).

Taxpayer argues that 20 items of metal fabricating equipment are used in the direct production of taxpayer's various products. To that end, the taxpayer has provided information which describes the manner in which 20 items of equipment are employed by the taxpayer and the number identifying the particular part being manufactured. A Lincoln 250 Wire Welder, Lincoln Welder, Lincoln 150 Welder, and Lincoln 255 Welder are employed by the taxpayer to assemble saddle rack weldments (PN: BIS103) for a horse trailer manufacturer. These four items of equipment are further identified as E9702, E9716, E9718, and E9732.

Taxpayer uses a Wysong Brake Press and Verson Break Press to form straps (PN: 33LDTRL) for a boat trailer manufacturer. These two items of equipment are identified as E9708 and E9723.

Taxpayer uses Niagra Shears to cut steel sheet in the manufacture of grain equipment hoppers (PN: DG3800). This item of equipment is identified as E9724.

Taxpayer uses a Hydro Mech 8-20 Band Saw is used to cut hopper cone legs (PN HO24-40) for grain equipment dealers. This item of equipment is identified as E9729.

Taxpayer uses a Uni-Hydro Iron Worker to shear and punch the front fork (PN: 10183) for a lawn mower manufacturer. This item of equipment is identified as E9703.

Taxpayer uses a Alva Allen Punch Press and a 40 Ton Punch Press to shear and form window bars (PN: B18143) for a horse trailer manufacturer. These two items of equipment are identified as E9704 and E9722.

Taxpayer uses a Boyer Schultz Surface Grinder, a Millport Milling Machine, a South Bend Lathe, a Surface Grinder, and a Bison Chuck for machining and finishing a slam latch (PN: BIS001A) for a horse trailer manufacturer. These five items of equipment are identified as E9705, E9706, E9710, E9713, and E9717.

Taxpayer uses a Torch Table and Plasma Arc to cut shapes (PN: LHS016) for a lawn ornament manufacturer. These two items of equipment are identified as E9711 and E9712.

Taxpayer uses a Power Roller to roll transitions rings (PN: DG1610) for grain equipment dealers. This equipment is identified as E9725.

Taxpayer uses an Airless Paint Sprayer to paint sprayer trailers (PN: TRL71) for spray equipment dealers. This item of equipment is identified as E9731.

Taxpayer has provided evidence purporting to establish that the preceding 20 items of equipment are involved in the direct production of tangible personal property. Based upon the evidence provided by the taxpayer, taxpayer has set out an argument that the 20 items of equipment are employed as essential components in an integrated process by which taxpayer produces various metal fabrications. According to taxpayer, the use of the equipment is confined to taxpayer’s business site and is not used in the final assembly or installation process at the customer’s location. According to taxpayer, the 20 items of equipment act in such a way as to have an immediate effect on the tangible personal property being produced. Therefore – subject to verification by a supplemental audit – the leasing of the 20 items of equipment is entitled to the sales tax manufacturing exemption afforded under IC 6-2.5-5-3(b).

FINDING

Subject to the determination of the supplemental audit, taxpayer’s protest is sustained.

DK/PE/MR – 010308